No. 86-860

IN THE

Supreme Court of the United States

OCTOBER TERM 1986

WALTER T. WALKER, III, Individually
and as Class Representative,
Petitioner,

v.

ACTION INDUSTRIES, INC., AMOS COMAY,
ERNEST BEREZ, and SHOLOM COMAY,
Respondents,

REPLY BRIEF FOR PETITIONER

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I.

Respondents wrongly assert that the opinion of the Fourth Circuit did not adopt a rule that federal securities laws do not require disclosure of financial projections, such as substantial increases in firm sales orders and projections of substantial increases in net income, in an issuer tender offer, even where a reasonable investor would find such information material and would clearly be influenced in reaching a decision to sell. Br. in Opp. at 9-11. The Fourth Circuit erroneously concluded that federal securities laws do not impose a duty to disclose the type of financial projections here in question. Pet. at 14-15.

Respondents simply ignore the unambiguous language of the appellate court opinion which states:

> The Fourth Circuit has not had the occasion to consider the issue of whether there is a duty to dis-

> close financial projections. . . . Now faced with a case that involves financial projections, we conclude that under the circumstances of this case Action had no duty to disclose its financial projections in the August 18 press release, for the reasons that follow . . . .
>
> First, . . . [t]here is no requirement under these regulations that financial projections be disclosed . . .
>
> Second, the SEC has not imposed a duty to disclose financial projections in disclosure documents generally. . . . We perceive the current SEC regulatory environment to be an experimental stage regarding financial projection disclosures. Respecting these evolutionary processes, we believe that a further transition, from permissive disclosure to required disclosure, should be occasioned by congressional or SEC adoption of more stringent disclosure requirements for financial projections, rather than by the courts.
>
> Third, we are reluctant to recognize a duty to disclose financial projections in this case because of their uncertainty and their potential to mislead investors.

802 F.2d at 709; App. at 12a-13a.

In affirming the trial court's instruction that "[t]here is no duty on a corporation to disclose future projections," the Fourth Circuit created a *per se* rule that corporations need not disclose soft information. 802 F.2d at 704; App. at 2a.

II.

Respondents also err in asserting that the holding of the Fourth Circuit is not in conflict with disclosure rules adopted by other circuits.[1] Br. in Opp. at 9-11. The opin-

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[1] Respondents also make the puzzling and contradictory argument that "even if conflicting rules exist, *the court below expressly did not adopt any of them.*" Br. in Opp. at 10. (Emphasis in original). Respondents thus concede that the Fourth Circuit rejected the con-

ion of the Fourth Circuit readily acknowledges the existence of such conflicts:

> The circuits which have addressed whether there is a duty to disclose financial projections, and other soft information such as asset appraisals, have reached varying results. These can be described as falling into three groups.

802 F.2d at 707; App. at 10a.

As noted in the petition, if this case had been tried in the Third Circuit, petitioner would have been entitled to have a jury as the trier of fact determine respondents' duty to disclose the financial projections, taking into account the factors announced by the Third Circuit in *Flynn v. Bass Brothers Enterprises, Inc.*, 744 F.2d 978 (3d Cir. 1984). Pet. at 17-19, n.12 and n.14. Further, the holding of the Fourth Circuit in *Walker* directly conflicts with the holding of the Third Circuit in *Rothberg v. Rosenbloom*, 771 F.2d 818, 821 (3d Cir. 1985), that substantial increases in firm sales orders are indeed material information which must be disclosed under Rule 10b-5.

If this case had been litigated in the Sixth or Ninth Circuit, a factual issue would have existed for the jury to determine whether respondents knew with "reasonable certainty" on July 16, 1982 that the Action Dollar-Ama firm sales for that quarter were at least double the firm sales for the same period in the prior fiscal year. Pet. at 19, n.14.[2]

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flicting disclosure analyses of other circuits in favor of its own rule, one which respondents characterize as a "non-rule."

[2] The general duty owed by respondents to Action's minority shareholders to make full and fair disclosure arises from issuance of the tender offer. 802 F.2d at 706-707; App. at 8a. Since respondents owed the same duty to all shareholders, regardless of whether they tendered their shares, the issue of whether this is an "insider trading" case is not crucial to this Court's decision. Br. in Opp. at 9. It is, however, undisputed that the individual respondents were controlling officers, directors and shareholders who affirma-

III.

Respondents' Counterstatement of the Case, which purports to correct inaccuracies in petitioner's Statement of the Case, fails to challenge key undisputed facts in the case. At the time of the tender offer, respondents' internal business records showed that Action had booked $19.6 million of "firm" sales for the Dollar-Ama Division for the quarter then in progress, as compared with $9.4 million for the prior year, an *increase of 109 per cent.* 802 F.2d at 709; App. at 14a; Pet. at 5. Respondents do not dispute the fact that at no point after the commencement of the tender offer did Action's projections show less than a doubling of Dollar-Ama sales over the same quarter in the prior year. Joint Appendix at 3157-3160, 3357-3391. The question before the Court is the issue of whether the jury evaluated this evidence under proper legal standards, *i.e.*, whether the jury was erroneously instructed on the issue of Action's duty to disclose future projections.[3]

IV.

Respondents owed no unique duty of disclosure to petitioner. Respondents' initial and continuing duty to disclose is the same for all Action minority shareholders regardless of any individual factual differences. Pet. at

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tively initiated the tender offer. Respondents were in sole possession of the favorable undisclosed information. As a result of their issuer tender offer purchase of stock at $4.00 per share, respondents increased their control of the corporation and benefited substantially when the value of their Action stock increased tenfold in less than one year. Pet. at 2, 4-6.

[3] To the extent there are factual disputes over how certain Action's "firm" orders were and whether Action's internal projections were "unique," misleading, inaccurate or constantly changing, these issues should have been decided by the jury. *Berg v. First American Bankshares, Inc.*, 796 F.2d 489, 495 (D.C. Cir. 1986); Pet. at 10-11.

13-14.[4] Also, as we state in our petition, under well-settled securities laws principles respondents have no unique factual or legal defenses to petitioner's claim of securities fraud which would justify denial of class certification. Pet. at 22-23.

V.

The Fourth Circuit wrongly held that Action's internal sales and income forecasts were not material as a matter of law. This holding is contrary to long-established policies of the SEC and disclosure rules adopted by the other circuits. This decision undercuts the primary purpose of the antifraud provision of the Securities Exchange Act "to ensure disclosures by corporate management in order to enable shareholders to make an informed choice." *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 448 (1976). This erroneous legal holding by the Fourth Circuit has broad implications in tender offers, proxy statements, mergers and acquisitions which far transcend the factual circumstances of the instant case.

In sum, there is an immediate and urgent need for the Supreme Court to end existing confusion and uncertainty and to provide guidance to lower courts concerning disclosure requirements for material information based in part upon future financial projections and soft information.

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[4] Respondents also wrongly claim that other litigation arising out of the tender offer was settled on a non-meritorious basis as a result of trial court pressure. Br. in Opp. at 6 n.3. Respondents, however, settled with the twenty-one plaintiffs in *McIntire, et al. v. Action Industries, Inc., et al.*, Civil Action No. 83-0198-A, by paying them, in addition to the $4 tender offer price, damages in the amount of aproximately $6 per share. In view of the maximum damage claim in the current case of approximately $9 per share, this $6 per share settlement cannot be fairly characterized by respondents as less than "successful."

For these reasons and the reasons stated in the petition, it is respectfully submitted that the petition for writ of certiorari should be granted.

Respectfully submitted,

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